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IN THE

Supreme Court of the United States

October Term, 1946

No.

IN THE MATTER

of

NEW YORK, ONTARIO AND WESTERN RAILWAY COMPANY,

Debtor,

THE PEOPLE OF THE STATE OF NEW YORK, THE DIRECTOR OF DIVISION OF SELF INSURANCE, THE INDUSTRIAL COMMISSIONER and the WORKMEN'S COMPENSATION BOARD OF THE STATE OF NEW YORK,

Petitioners,

against

RAYMOND L. GEBHARDT and FERDINAND J. SIEGHARDT, as Trustees of the above named Debtor,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

Petitioners pray for a writ of certiorari to review a decree of the Circuit Court of Appeals for the Second Circuit entered January 13, 1947 (R. 72), which modified an order of the District Court of the United States

for the Southern District of New York, dated April 18, 1946, by eliminating the State of New York as a party and providing for dismissal of the petition as to it, and, as so modified, the order appealed from was affirmed (R. 72).

Respondents, as Trustees of the property of the Debtor, undergoing reorganization under Section 77 of the Bankruptcy Act, instituted a proceeding by petition in the Bankruptcy Court for a turn over order with relation to a security deposit of the Debtor, amounting to $160,000 par value of bonds, which prior to bankruptcy had been deposited by the Debtor as security for the performance of its obligations arising under the Workmen's Compensation Law of the State of New York (R. 42-49).

The order to show cause annexed to said petition and served with it was directed solely to the Director of Division of Self Insurance, The Industrial Commissioner and the Workmen's Compensation Board. The State of New York was not included as a party (R. 41).

The parties against whom the order to show cause was directed appeared by answer in which the People of the State of New York voluntarily joined. The answer is in the nature of a demurrer, denying none of the allegations of the petition, but raising a question as to the jurisdiction of the Court (R. 55-56).

The order of the District Court followed in which the securities, constituting the security deposit, were directed to be turned over to said Trustees (R. 31, 32, 33). An appeal was taken from that order to the Circuit Court of Appeals for the Second Circuit, which appeal was dismissed on the jurisdictional ground that it was not a final order.

The parties then entered into a stipulation as to the facts to which stipulation various exhibits were annexed

as a part thereof (R. 9-26). The stipulation was submitted to the Court upon the further petition of said Trustees praying for a summary order against the person, persons or Board possessed of the security deposit, which by then had been reduced to $80,055.03 by the voluntary surrender to the Trustees of $79,944.97 par value of securities (R. 25-27).

Said petition was followed by the order of the District Court, dated April 18, 1946, requiring the persons possessed of the security deposit, consisting of specifically described bonds, to surrender the same to said Trustees (R. 7, 8). From that order an appeal was taken to the Circuit Court of Appeals (R. 4, 5), which resulted in a modified affirmance. It is from this decision of the Circuit Court that the petitioners seek a writ of certiorari.

Facts.

The facts are fully set forth in said stipulation and in the exhibits annexed to and forming a part thereof.

The salient facts are that these securities are the property of the Debtor; and that long prior to the filing of the Debtor's petition for reorganization the Debtor deposited said securities with the Industrial Commissioner of the State of New York pursuant to subdivision 3 of Section 50 of the Workmen's Compensation Law to provide the security contemplated by law necessary to establish the Debtor as a self-insurer (R. 10).

The Trustee of the Debtor's property made due application for the release and surrender of the security deposit. On January 27, 1944, the Director of Division of Self Insurance, acting for the Commissioner of the Department of Labor of the State of New York, advised the Trustee by letter to the effect that the Industrial Commissioner had authorized and approved the release

of the security deposit on certain conditions, namely: that $79,944.97 be paid into the Aggregate Trust Fund; that certain obligations and administrative expenses be paid and that a self-insurance report be filed; and that there be provided a self-insurance release policy in the amount of $75,000 as security for the obligations arising out of the self-insurance periods specified (R. 11, 12).

All the conditions imposed were complied with (R. 13, 14). Thereafter the Director of the Division of Self Insurance, acting on the instructions of the Attorney-General, refused to turn over the deposit (R. 15).

Opinions Below.

The District Court by its unreported opinion, dated September 20, 1945, held that the securities were deposited with the Industrial Commissioner for the specific purpose of insuring the indemnification of the employees of the Debtor for any liability to its employees, arising under the provisions of the Workmen's Compensation Law; and that no right existed to dispose of the securities for any other purpose and that since all obligations intended to be secured were fully satisfied and discharged the Trustees presumptively are entitled to the return thereof (R. 33-40; fol. 117).

The subsequent opinion by the District Court, also unreported, is merely an announcement of its decision (R. 9).

The Circuit Court of Appeals rendered an opinion which is reported in 158 Fed. (2d) 769.

ARGUMENT.

POINT I.

The estate of the Debtor is summarily entitled to the return of its pledged property in which petitioners have no pecuniary interest; and the eleventh amendment is not applicable.

(a) The Industrial Commissioner received the deposit for the specific purpose of securing the liability of the Debtor to its employees for injuries arising under the Workmen's Compensation Law. Had the Debtor defaulted in that liability, of course, the deposit would have been applicable to make good the awards to the employees. However, there was no such default. Instead, the Director of Self Insurance designated the conditions upon which the deposit would be surrendered and returned. The District Court authorized the Trustees to comply with those conditions. One was the payment of $79,944.97 into the Aggregate Trust Fund to effect payment of the death claims. Another was the procurement by the Trustees of a self-insurance release policy for $75,000 to secure any contingent or future liability which might arise with relation to injuries not resulting fatally. Under the statute (§50, subdivision 3) that policy can never be cancelled.

When the Trustees had fulfilled all of the conditions imposed they were confronted with the manifestly unfair position that the Industrial Commissioner would refuse to discharge his fiduciary obligation and return the securities because of the direction by the Attorney-General, who undertook to divert the deposit to an obligation of the Debtor entirely foreign to the subject-matter of Workmen's Compensation.

Remington on Bankruptcy (5th Edition, Vol. 4), Section 1447 states:

> "§1447. Set-off by Pledgee of Excess Collateral against Unsecured Claims—The application of surplus collateral to a debt not secured by it is in the nature of a conversion. When the trustee sues to recover surplus collateral, the pledgee cannot set off counterclaims based on independent contracts."

Cardozo, J., writing for the New York Court of Appeals in *Morris v. Windsor Trust Co.* (213 N. Y. 27, 29), said:

> "I think the set-off is without sanction, either statutory or equitable. A wrongdoer who has misapplied the subject of a trust is not entitled, either under the Bankruptcy Act or under the rules of equitable set-off, to apply a credit that belongs to him in his own right in cancellation of his liability as a fiduciary. * * *
>
> "* * * This Court has many times held that a contract of pledge creates a fiduciary relation between the pledgor and pledgee. * * * After the debt secured by the pledge has been paid, the defendant held the pledge without beneficial interest or power of disposition. The one duty remaining was to preserve it safely and return it to the pledgor."

The Courts of the State of New York are not alone in requiring faithful compliance with fiduciary obligations.

In *Libby v. Hopkins* (104 U. S. 303) plaintiffs claimed the right to set-off an unsecured debt due from Hopkins against a sum of money remitted to plaintiffs by him with directions to apply it on his mortgage debt. This the plaintiffs refused to do and instead applied it on the unsecured debt. The Court in its opinion (p. 308) said:

> "Hopkins sent them the money and drafts, upon the faith and trust that they would be applied

> according to his instructions. The refusal so to apply them did not change the relations of the parties to this fund, nor make that a debt which before such refusal was a trust. To so hold would be to permit a trustee to better his condition by a refusal to execute a trust which he had assumed."

In *Alvord v. Ryan* (212 Fed. 83 C. C. A. 8th) it appeared that Alvord prior to his adjudication as a bankrupt delivered over to the defendant the title and possession of certain cattle to secure and indemnify the defendant for possible liability on an undertaking which he had executed upon request. The condition upon which the defendant might have become liable upon the undertaking did not arise. She sought to set-off the value of the cattle against an unsecured claim which she had against the bankrupt, but the Court (p. 87) held that this she was not permitted to do; that the defendant was the trustee of the plaintiff and that her holding of the money was not in the same right as was her holding of the claim against him; that the latter was personal whereas the former was fiduciary; that these were not mutual credits within the meaning of Section 68a of the Bankruptcy Act; and that the right of set-off did not exist.

In re Autler (23 Fed. Supp. 756) is another case of an attempted set-off of trust property to satisfy an individual claim against the bankrupt for breach of contract. Our Secretary of War, when a District Judge for the Southern District of New York, held that Section 68a only has application where the bankrupt and the creditor owe one another and does not apply where the bankrupt's property is in possession of a creditor as bailee or trustee.

The effort to set-off the security deposit against an obligation of the Debtor arising under the Grade Crossing Elimination Act of the State of New York is unwarranted under the rules of law or equity and is not

authorized or contemplated by the provisions of that statute (Chapter 678 of the Laws of 1928). Section 4, Subdivisions 2 and 3, of that statute provide for the repayment of funds advanced to the railroad; and in the event of failure or refusal of the railroad company to repay the installments as they fall due the same may be recovered as provided by Subdivision 3 of that section, which provides:

> "The comptroller may certify the amount or amounts so due and payable to the board of supervisors of the county or counties in which the crossing is located, whereupon, it shall be the duty of such board of supervisors to apportion the amount or amounts so certified to the several towns and cities in such county according to the assessed valuation of the real property of such railroad corporation or corporations or the successor or successors thereof in such respective towns and cities and to place the several amounts so apportioned on the respective assessment rolls of such towns and and cities and to issue its warrant or warrants for the collection thereof. Thereupon it shall become the duty of such towns and cities through their proper officers to collect the respective several amounts so apportioned in the same manner as other taxes are collected in such towns and cities and when collected to pay the same to the county treasurer of such county who shall thereupon pay the same into the state treasury. Any amount so levied shall thereupon become and be a first and paramount lien upon all real property of such railroad corporation or corporations or the successor or successors thereof within such respective towns and cities."

The validity and effect of the foregoing provision was before the Circuit Court of Appeals in a proceeding wherein it was sought to be determined that the mortgage liens upon the property of the Debtor had priority over any lien created pursuant to the provisions of the stat-

ute; and it was held that the mortgages were subordinate to the grade crossing lien.

> *State of New York v. Gebhardt, et al.*, 151 Fed. (2d) 802.

There exists nothing in the statute referred to to give any right to the State to the security deposit and nothing therein justifies a breach by the State or by its representatives of the provisions of the trust created by the third subdivision of Section 50 of the Workmen's Compensation Law.

(b) Petitioners have no pecuniary interest in the securities and the Eleventh Amendment, therefore, has no application. The claim to the contrary is without substance. Compliance with the summary order will have no bearing or effect upon the political or property rights of the State.

The Circuit Court of Appeals for the Second Circuit *In re Faour* (72 Fed. [2d] 719, aff'd 293 U. S. 613) considered a case where the debtors in bankruptcy had been private bankers. Pursuant to the New York Banking Law the state superintendent of banks had taken over all their assets for the purpose of liquidation. Thereafter petition was presented to the Federal Court for a composition under Section 74 of the Bankruptcy Act. The Federal receiver then made application for summary order to have the Superintendent of Banks turn over all property and to account for any paid out. Chase, J., among other things, said:

> "* * * Within its sphere the jurisdiction of a court of bankruptcy is paramount. * * *"
>
> "The District Court sitting in bankruptcy has ample power to administer all of the property and by summary order to require the appellant to turn it over to be administered."

This Court in *May v. Henderson* (268 U. S. 111, 69 L. Ed. 871), reversed the Court of Appeals for the Ninth Circuit and sustained the District Court in summarily directing the payment of money over to the trustee in bankruptcy. The late Mr. Justice Stone, writing for this Court, said at page 115:

> "• • • *But property held or acquired by others for account of the bankrupt is subject to a summary order of the court, which may direct an accounting and a payment over to the trustee or receiver appointed by the bankruptcy court.* (Cases cited.) • • • Courts of bankruptcy do not permit themselves to be ousted of jurisdiction by the mere assertion of an adverse claim. • • • It may disregard the assertion that the claim is adverse if, on the undisputed facts, it appears to be merely colorable. (Cases cited.)
>
> "• • • Having assumed to take possession of the property of the bankrupt for its account, it was their legal duty to turn the property or its proceeds over to the trustee in bankruptcy, or to account for their inability to do so by showing either a disposition of it in performance of a legal duty assumed toward the bankrupt or the bankrupt's trustee, or by clothing themselves with the protection of a claim adverse to the bankrupt, which was not merely colorable." (Italics supplied.)

See also:

Hopkins v. Clemson College, 221 U. S. 636, 31 S. Ct. 654, 55 L. Ed. 890, 35 L. R. A. (N. S.) 243.
Porter v. Beha, 12 Fed. (2d) 513, 517.
Cook County National Bank v. U. S., 107 U. S. 445.
Osborn v. United States Bank, 9 Wheat. 738.
Davis v. Gray, 16 Wall. 203.
In re Bajardi, 9 Fed. (2d) 797, cert. den. 270 U. S. 651.
Gamble v. Daniel, 39 Fed. (2d) 447, C. C. A. 8th Circuit; appeal dismissed 281 U. S. 705; cert. den. 282 U. S. 484.

Answering Petitioners' Brief.

The first two points of petitioners' brief propound legal doctrines with which this Court is not now concerned, since they have no application under the facts as stipulated. However, some observations and analysis of the cases cited by petitioners may be helpful to the Court.

Petitioners' Point I.

Notwithstanding the fact that the Court below dismissed the petition as against the State, the latter by joining in the petition for the writ is still insistent upon remaining in the proceeding as a party.

Petitioners say (p. 7) that the elimination of the State as a party does not alter the fact that the suit is still against the State, asserting that the immunity of the State from suit cannot be circumvented by limiting the suit to one against its officials. In support of this contention, petitioners have cited several cases, beginning with *Louisiana v. Jumel.*

None of these cases have any application. In each the property involved was that in which the State had a proprietary interest. The State, therefore, was the real party against whom the relief was sought.

Petitioners say (p. 8) that the State has directed its official to apply the property in question to an indebtedness owing by the Debtor and that the order of the Court below is in direct conflict with these instructions by reason of which it is said that the suit is actually against the State. Several cases are cited in support of the contention, beginning with the case of *Lankford v. Platte Iron Works.* None are controlling nor have they any application on the facts presented by this record. The

subject-matter of every one was something in which the State had a proprietary interest. None of them held or supported the position that the State has any legal right to direct its officials to become wrongdoers in violation of a lawful decree.

Petitioners' Point II.

The decision of the Circuit Court of Appeals does not conflict with any decision by this Court.

Great Northern Life Insurance Co. v. Read does not support petitioners' contention. This Court in its opinion (p. 51) said that a State could not be controlled by "courts in the performance of its political duties through suits against its officials."

Ford Motor Co. v. Department of Treasury of the State of Indiana was instituted by petitioner in the District Court of the United States for the Southern District of Indiana to compel a refund of gross income taxes paid to the Department. Of course, the suit was one against the State in which the latter had a direct pecuniary interest, the subject-matter being taxes already paid into the Treasury of the State as to which a refund was sought.

Kennecott Copper Corp. v. State Tax Commission involves the question as to the jurisdiction of the District Court with relation to a suit instituted to recover taxes illegally collected. Clearly the State was the real party in interest. Mr. Justice Reed, writing for the Court, said (p. 673):

> "This is a suit against the state. Utah has established an adequate procedure for the recovery of taxes illegally collected. When the state collects a tax under protest, the money is segregated and held for the determination of the taxpayers' rights with provision for any deficiency for interest or costs to be paid by the state."

Mine Safety Appliances Company v. Forrestal resulted in a dismissal of the complaint in which it is held that the United States was an indispensable party, Mr. Justice Black, who delivered the opinion of the court, saying (p. 167):

> "* * * The sole purpose of this proceeding is to prevent the Secretary from taking certain action which would stop payment by the government of money lawfully in the United States Treasury to satisfy the government's and not the Secretary's debt to the appellant."

In the Matter of State of New York this Court held that whether a suit is one against a State is determined "by the essential nature and effect of the proceeding, as it appears from the entire record" (p. 500). The proceeding involved the question of liability for damage occasioned while tugs were under charter to the Superintendent of Public Works and it was held that the proceeding essentially was one against the State.

It is well settled that a suit against an officer or agent of a State or of the United States is not necessarily a suit against the State or the United States; and that where the officer or agent makes claim to the contrary the burden is upon him to show that the State is the real party in interest; and that the Eleventh Amendment gives no immunity to officers or agents of a State withholding the property of a citizen without authority of law.

Tindal v. Wesley, 167 U. S. 204.
Sterling v. Constantin, 287 U. S. 378, 393; 77 L. Ed. 375.
U. S. v. Lee, 106 U. S. 196, 215, 216.

For decisions of State Courts holding to the same effect see:

Gladding v. Atchison, 44 R. I. 69; 115 A. 423.
State Mineral Lease Commission v. Lawrence, 171 Miss. 442; 157 So. 897, 898.

Thompson v. Auditor General, 261 Mich. 624; 247 N. W. 360, 362.
Dunne v. State, 162 Md. 274; 159 A. 751.
Alfred v. Esser, 91 Colo. 466; 15 P. 2d 714, 715.

Petitioners' Point III.

Petitioners say that the mere fact that the State claims title to the fund was sufficient to deprive the Court of jurisdiction, a position in conflict with the decision by this Court in *May v. Henderson, supra.*

Siegel v. State of New York is one where the receiver in bankruptcy surrendered a liquor license and became entitled to a refund. The State, however, applied the refund in payment of taxes due from the bankrupt. There, however, the refund merely constituted a debt to the bankrupt without any fiduciary relationship. Furthermore, the Liquor Law provided that on an application for payment of a refund all taxes and penalties due the State shall be deducted therefrom. No such provision is contained in the Workmen's Compensation Law.

Petitioners cite only a portion of Section 266 of the Civil Practice Act as amended in 1936, which has the effect of leaving the Court in the dark as to the purpose and scope of the section. It follows:

> "§266. Counterclaim defined.
>
> "A counterclaim may be any cause of action in favor of the defendants or some of them against the plaintiffs or some of them, a person whom a plaintiff represents or a plaintiff and another person or persons alleged to be liable."

A mere definition of a counterclaim is not calculated to change the substantive law. The section prior to amendment permitted a party to counterclaim a cause of action which arose out of the same transaction set forth

in the complaint or which was connected with the subject of the action, except that a cause of action on contract was the proper subject of counterclaim against any other cause on contract. The amended definition of a counterclaim includes any cause of action in defendant's favor against the plaintiff.

But there still must be a cause of action without which, of course, there can be no counterclaim; and it must be a cause of action of substance before it can be sued upon or counterclaimed.

The position of petitioners that the decisions in *Morris v. Windsor Trust Company* and *Pink v. Title Guarantee and Trust Co.* are now impaired by reason of the amended definition of a counterclaim is clearly unfounded.

The opinion of Cardozo, J., in the *Morris* case recognized that the counterclaims probably did not come within the enumerated classes of the statute, and the dismissal of the counterclaims resulted rather from the determination that the set-off was without any legal sanction and because the defendant was undertaking to repudiate its fiduciary obligation by reason of which it was referred to as a wrongdoer.

The reference in petitioners' brief (p. 15) to the *Pink* case is inaccurate and may well be misleading. A quotation is set forth from page 172 of the prevailing opinion and united with it without justification or reason is a quotation from the dissenting opinion; and the assertion is not well founded that the decision was limited to the construction of former Section 266. Instead, the Court was careful to point out that the claims of the parties were not held in the same right (p. 176).

Kaufman v. Providence Savings Bank & Trust Co. does not aid petitioners. There the plaintiff borrowed money of the defendant on a note and put up securities

as collateral thereto. The owner of the note then sold the collateral and plaintiff sued the noteholder for conversion. The Court held that a set-off was proper, since the debt owing by the maker of the note was admittedly overdue and unpaid at the time of the suit. Obviously no criticism can be directed against the conclusion of the Court. If the debtor here had defaulted on its workmen's compensation obligations, the Industrial Commissioner could have disposed of the security deposit to satisfy those obligations. That was the very purpose in making the deposit.

See:

Hughes v. Murphy, Inc., 169 Misc. 239.

CONCLUSION.

It is respectfully submitted that no question is presented which warrants a review by this Court, and it is urged that the petition be denied.

Dated, April 12, 1947.

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APPENDIX.

Vol. 64, Part 2 of McKinney's Consolidated Laws:

"§50. Security for payment of compensation.

"An employer shall secure compensation to his employees in one of the following ways:

"1. * * *

"2. * * *

"3. By furnishing satisfactory proof to the commissioner of his financial ability to pay such compensation for himself, in which case the commissioner shall require the *deposit* with the commissioner of such securities as the commissioner may deem necessary of the kind prescribed in subdivisions one, two, three, four and five, and paragraph a of subdivision seven of section two hundred and thirty-nine of the banking law, in an amount to be determined by the commissioner to *secure his liability to pay the compensation provided in this chapter.* The commissioner may also require an agreement on the part of an employer to pay any awards commuted under section twenty-seven of this chapter, into the special fund of the state fund, as a condition of his being allowed to remain uninsured pursuant to this section. The commissioner shall have the authority to deny the application of an employer to pay such compensation for himself or to revoke his consent furnished, under this section at any time, for good cause shown. The employer qualifying under this subdivision shall be known as a self-insurer.

"*If for any reason the status of an employer under this subdivision is terminated, the security bond deposit* referred to herein shall remain in the *custody* of the industrial commissioner for a period of at least twenty-six months. At the expiration of such time or such further time period as the commissioner may deem proper and warranted under the circumstances, and so designates, the commissioner may accept *in lieu thereof,* and for the

additional purpose of securing such further and future contingent liability as may arise from prior injuries to workers and be incurred by reason of any change in condition of such workers warranting the industrial board making subsequent awards for payment of additional compensation, *a policy of insurance furnished by the employer,* his heirs or assigns or others carrying on or liquidating such business. Such policy shall be in a form approved by the superintendent of insurance and issued by the state fund or any insurance company licensed to issue this class of insurance in this state. It shall only be issued for a single complete premium payment in advance by the employer. *It shall be given in an amount to be determined by the industrial commissioner and when issued shall be noncancellable for any cause* during the continuance of the liability secured and so covered." (Italics supplied.)